No. 16295

IN THE

nited States Court of Appeals

FOR THE NINTH CIRCUIT

Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Thomas Wolff, Jr., and Stanley Marks,

Appellants

vs.

Securities and Exchange Commission,

Appellee.

---

peal From and Order and Judgment of the United States District Court for the Southern District of California.

Brief for Appellants Trust Deed & Mortgage Exchange, and David Farrell.

FILED

J. Foley,
Woodward Building,
Washington 5, D.C.,
(National 8-1111),
Attorneys for Appellants Trust Deed & Mortgage Exchange and David Farrell.

& Son, Inc. Law Printers, Los Angeles. Phone MA. 6-9…

TOPICAL INDEX

PAGE

Argument 2

Brief Description of Appellants' Business 2

A. Buying Function as Principal 2

B. Selling Function as Principal 4

I.

SEC Has No Jurisdiction Over Business of Defendant-Appellants 6

(a) Status of Mortgages in the Field of Finance as Not a "Security" 6

(b) Legislative History Establishes Mortgage and Trust Deeds Not a "Security" 11

(c) Trust Deeds as Sold by Defendant-Appellants Do Not Become "Investment Contracts" 19

C. SEC Stipulated That This Was a National Test Case to Determine Its Jurisdiction, Yet, Induced Trial Court to Deny Discovery of Proof of Lack of Jurisdiction 25

D. This Court Directed Findings of Fact Regarding an "Investment Contract" 26

E. Customer Witnesses Called by SEC Failed to Establish Necessary Ingredients of an Investment Contract 27

F. The Economic Aspects of This Precedent on the Mortgage Industry Are Extremely Far-reaching 28

G. SEC Registration and Procedures Having Been Intended for an Entirely Different Field Are Totally Inapplicable to the Sale of Individual Trust Deeds by Appellant and There Is No Manner in Which They Could Be Complied With 33

H. SEC Has No Jurisdiction to Seek or Obtain a Receiver 33

PA

I. Appellant Corporations Were Solvent..........................

J. Broker-Dealer Formula Regarding Net Capital Rule Totally Inapplicable and Misapplied..............................

K. Cumulative Effect of Numerous Errors in Admitting Evidence Offered by SEC Require Reversal on That Ground ....

L. The District Court Erred in Not Granting Motion for Mistrial After Days of Trial With Certain Defendants and Their Counsel Gagged............................

M. Denial of All Discovery Rights to the Appellants and Granting Carte Blanche Discovery Rights to the Appellee Constituted Prejudicial Error........................

N. The Case Was Prejudged as Established by Certain of the Trial Judge's Comments....................................

TABLE OF AUTHORITIES CITED

Cases

PAGE

Bley v. Proctor, 160 F.2d 78 (1st Cir., 1947) 39

Dckert v. Independence Shares Corp., 311 U.S. 282, 61 S.Ct. 229 38

Grdon v. Washington, 295 U.S. 30, 55 S.Ct. 584 (1935) 40

Hme Mortgage Co. v. Ramsey, 49 F.2d 738 (4th Cir., 931) 37, 40

Jdes v. SEC, 298 U.S. 1 10

Mxwell v. McDaniels, 184 Fed. 311 (4th Cir.) 37

Cs & Co. v. SEC, 106 F.2d 579 34

Prter v. Warner Holding Co., 328 U.S. 395, 397 37

Psey and Jones Co. v. Hanssen, 261 U.S. 491, 43 S.Ct. 454 38

SC v. Aldred Investment Trust, 151 F.2d 254 (1st Cir., 945) 39

SC v. Fed. Compress and Warehouse Company (D.C. V.D., Tenn., 1936) CCH Securities Rep, Secs. 2911.22, 0106, 1941-1944 Dec 34

SC v. Fiscal Fund, 48 Fed. Supp. 712 (D. Del., 1943) 39

SC v. Howey, 328 U.S. 293 .... 7, 15, 19, 27

SC v. Torr, 87 F.2d 446 34

SC v. Valie No. 14253 (now 257 F.2d 201) 19

Stte v. New Orleans Debenture Company, 107 La. 562, 32 o. 102 38

Stnberg v. Vineland Trust Company, 107 N. J. Eq. 255, 53 Atl. 370 38

Tlor v. Michigan P. U. Com., 186 N.W. 485 10

Uted States v. Moore, 340 U.S. 616 37

Regulations and Rules

6 Federal Regulations 3053 15

8 Federal Regulations 3115 15

eeral Rules of Civil Procedure, Rule 37(b) 43

Rules of the Securities Exchange Commission, Rule 15a-.... 14
Rules of the Securities Exchange Commission, Rule 230..... 13
Rules of the Securities Exchange Commission, Rule 233a) 14

STATUTES

California Civil Code, Sec. 2948.... 7
California Code of Civil Procedure, Sec. 580(b).... 11
California Code of Civil Procedure, Sec. 726.... 11
Emergency Price Control Act, Sec. 205(a).... 37
Securities Act of 1933, Sec. 2(1).... 8
Securities Act of 1933, Sec. 2(a).... 9
Securities Act of 1933, Sec. 12.... 34, 38
Securities Act of 1933, Sec. 20.... 33
Securities Act of 1933, Sec. 20(a).... 33
Securities Act of 1933, Sec. 20(b).... 33, 35
Securities Act of 1933, Sec. 20(c).... 33
Securities Act of 1933, Sec. 24.... 34
Securities Act of 1933, Sec. 26.... 39
United States Code, Title 15, Sec. 7w.... 34
United States Code, Title 15, Sec. 77b(1).... 8, 9
United States Code, Title 15, Sec. 77aa(1-32).... 16, 33
United States Code, Title 15, Sec. 77ccc(1).... 17
United States Code, Title 15, Sec. 77ccc(7).... 17
United States Code, Title 15, Sec. 77 l.... 34, 38
United States Code, Title 15, Sec. 77t.... 33
United States Code, Title 15, Sec. 80a-3(c).... 18
United States Code, Title 15, Sec. 80b(17).... 16
United States Code Annotated, Title 15, Sec. 80a-26.... 39
United States Code Annotated, Title 15, Sec. 80a-35.... 39
United States Code Annotated, Title 50, Sec. 92(a) (1?6) 37
United States Code, Title 15, Sec. 80a-35.... 39

Miscellaneous PAGE

rican Jurisprudence, Receivers, Sec. 17 38
rican Law of Property, Vol. IV, pp. 3-6, 12 6
A rican Law of Property, Vol. IV, p. 107 10
Bl k's Law Dictionary 5
lk on Receivers, 3rd Ed. (1959), Secs. 180-182 37
gressional Record, 85th Cong., 1st Session, Vol. 103, Part p. 11632 35
Fi ncial Handbook (3rd Ed., 1948), p. 301 (Ronald Press) 6, 7
Fl her, Treatise on Corporations (1942 Ed.), Vol. 16, Sec. 87 38
Fl her, Treatise on Corporations (1942 Ed)., Vol. 16, Sec. 95 38
H se Report No. 55 11
H se Report No. 85, 73rd Cong., 1st Session, pp. 1, 2 11
H se Report No. 85, 73rd Cong., 1st Session, p. 11 8
H se Report No. 210, 73rd Cong., 1st Session, p. 1 12
H se Report No. 5240 11
H se Report No. 5480, 73rd Cong., 1st Session 11
J. inclair Armstrong, Current Developments in Regulation the Securities Market, Congressional Record, 85th Cong., t Sess., Vol. 103, Part 2, p. 2404 35
P eroy, Equity Jurisprudence (4th Ed.), Sec. 1539 39
P ell on Real Property (1952, published by Bender), Vol. p. 554 .... 7, 8
Se te Bill S. 2544, Congressional Record, 85th Cong., 1st ssion, Vol. 103, Part 9, p. 11631 et seq 36
St stical Abstract of the United States, 1959, published by reau of Census, U. S. Depart. of Commerce, p. 307 28

No. 16995

IN THE

Inited States Court of Appeals

FOR THE NINTH CIRCUIT

.. Angeles Trust Deed & Mortgage Exchange, rust Deed & Mortgage Exchange, Trust Deed Deed & Mortgage Markets, David Farrell, Oli- er J. Farrell, Thomas Wolfe, Jr., and Stanley . Marks,

Appellants,

vs.

Securities and Exchange Commission,

Appellee.

BRIEF FOR THE APPELLANT.

---

his Opening Brief on Behalf of Two of the ppellants; Namely, Trust Deed & Mortgage Exchange and David Farrell, Hereby Incorpo- r es by Reference the Entire Opening Brief I ed on Behalf of the Other Appellants in This tion. This Is Done in Order to Avoid Burden- i the Court and, Further, to Avoid Confusion a to What the Issues Are and the Position of t Appellants is. The Matter Contained in This Iief is Supplemental to the Other Brief Cover- i Aspects Which Are Generally Additional and I fferent.

EY TO REFERENCES: Throughout this brief the o wing symbols will be used:

R—Appellant's Record

T—Transcript

A—Appellants' Appendix to Brief

PX—Plaintiffs' Exhibit

DX—Defendants' Exhibit

ARGUMENT.

Brief Description of Appellants' Business

A. Buying Function as Principal.

The deeds of trust dealt in by the defendants might be divided into three principal groupings: namely (a) existing deeds of trust (usually second) on individual homes, bought in the open market; (b) first deeds of trust on individual lots in subdivisions which were in the process of development; and (c) deeds of trust in the Lamoor-Goheen transaction, later completely rescinded, which were similar to Class (b), *supra*, except that, instead of individual lots with normal street ingress and egress being covered by each trust deed, the land covered by each trust deed in the Lamoor-Goheen transaction did not have the provisions for streets.

As to Group (a), *supra*, there was usually no privity between any of the defendants, and the trustor or mortgagor and the defendants became familiar with the instrument only after it had been brought into being by the owner of the improved lot (usually the occupant) in connection with his purchase wherein his trust deed was given as part of the purchase price and later sold by the recipient thereof in order to reduce it to immediate cash by sale to one or more of the corporate defendants. The preponderance of the trust deeds sold by the defendants were of this group.

Regarding Group (b) above, each trust deed covered a particular individual lot in a regularly subdivided area. In some of these instances, Los Angeles Trust Deed & Mortgage Exchange paid a certain price outright for the individual trust deed with the further agreement that it would pay specified additional amounts for said trust deed when, as and if particular offsite improve-

...es such as (1) pavement of street, (2) installation of curbing, (3) installation of sewer or water, or (4) both offsite improvements were made. In such cases, Los Angeles Trust Deed & Mortgage Exchange acquired clear and unconditional title to the trust deeds and independently had its contractual commitments with regard to the further conditional disbursements upon performance of the specified conditions precedent. In the event the specified offsite improvements were not made within the designated period, Los Angeles Trust Deed & Mortgage Exchange could then make the aforesaid conditional payments to the then holder of the trust deed in order to reduce the balance thereof. Usually, these first trust deeds had individual subordination clauses whereby a subsequent loan within a designated dollar range made and used for the purpose of constructing a home on that particular lot could become a prior lien on the resultant lot and home within the terms of the aforesaid subordination clause. These practices are not unusual in the home building industry. In some of these instances, David Farrell, individually, became a participant in the company which intended to effect improvements and home construction in the particular subdivisions. This is a usual practice in the industry, and this type of dual role of corporate officer has been regularly acquiesced in by the Securities and Exchange Commission. [T 2530 *et seq.*, and DX-T.]

Regarding Group (c) covering the Lamoor-Goheen transaction, later completely rescinded, there was no provision for streets abutting upon the individual parcel covered by the trust deed. Defendants recognize this transaction as a mistake which was completely and voluntarily rescinded.

B. Selling Function as Principal.

One or more of the corporate defendants advertised and otherwise solicited and acquired customers to whom, on the basis set out in the current brochures, individual trust deeds were sold to individual customers. In most instances, the full purchase price was paid and clear and complete title to the trust deed along with the title policy covering same and other instruments typical in this type of real estate transaction were given to the customer, pursuant to his purchase authorization. If, after a customer had thus bought and paid for one trust deed, he wanted to buy a second on the installment plan, such a sale was made to the customer under such terms and conditions that it was anticipated by the parties that it would be fully paid for within the ensuing year by virtue of payments received from the trustor on the trust deeds this customer owned and/or installment payments made by the customer. Depending upon the indicated preference of the customer on purchase authorization, title could be recorded in his name in the public land records or taken in the name of one or more of the corporate defendants as trustee. If specifically requested by the customer, one or more of the corporate defendants would arrange to receive and transmit the payments on the aforesaid trust deeds according to the customer's instructions.

The defendants and none of them made any guaranty as to any of the trust deeds sold. It did, pursuant to a policy statement, endeavor on a best effort basis to liquidate the trust deeds of any of its customers

wh desired to liquidate same. The brochures parti-
cul ly indicated that there was no guaranty, nor did
i any wise guarantee that payments would be made
on ie trust deeds according to their terms.[1]

ie purchase authorization represents the contract
bet een any of the defendant corporations and its cus-
tom rs. The individual defendants herein did not, in
the individual private capacity, conduct the business
tra sactions complained of by the Securities and Ex-
cha ge Commission.

ie financial condition as of September 25, 1959,
a d e shortly before the commencement of the trial and
the atest date for which the financial condition of Los
An eles Trust Deed & Mortgage Exchange and Trust
De l & Mortgage Markets was put at issue, shows a
net vorth of $904,631.19 on a certified financial state-
me [DX 42] prepared by the company's independent
CP . who was called as a witness by the Securities
and Exchange Commission. The validity of this fi-
nan ial analysis was not refuted nor seriously disputed
by ecurities and Exchange Commission which merely
att pted by retroactive and manipulative entries to es-
tab sh an alleged insolvency as of one particular date;
nai ly, March 31, 1959.

[1] r purposes of clarity, it seems best to point out the appro-
pri terms for the problem here presented; namely, the dis-
tinc on between "guaranty" and "guarantee." According to
Bla 's Law Dictionary, the word "guaranty" means "A promise
to swer for the payment of some debt or the performance of
son duty, in the case of the failure of another person, who,
in t first instance, is liable to such payment or performance."
(Ci ng many cases.)

I.

SEC Has No Jurisdiction Over Business of Defendant-Appellants.

(a) Status of Mortgages in the Field of Finance as Not a "Security".

Since mortgages were undoubtedly used in early Anglo Saxon times and survived in the Norman Conquest, and since the 12th Century, we have had a detailed knowledge of their operation through the entire history of common law and even in the Roman law and the Code Napoleon,[2] it is not surprising that the mortgage has a unique status because of its common usage and its unique economic function.[3] The legislative history (*infra*) states the term "security" is used "as in our commercial world". In the "Financial Handbook" (Third Edition—1948) by Ronald Press which is widely recognized in the field of finance as authritative, the following pertinent part is quoted with regard to the status of mortgages within the general concept of real estate loans—page 301:

> "Real Estate Mortgages. Classifications.—Loan on real estate may be classified as (a) mortgage, (b) mortgage bond, (c) leasehold mortgage (d) debenture, and (e) income obligation. . . ."

For proper understanding of the issue presented in this case, it is necessary to clearly understand the difference between classification (a) and (b) in the foregoing list for the reason that each is handled by a separate and distinct industry and economic grouping. The mortgage itself (classification (a) above) is a unique in-

---

[2]American Law of Property, Vol. IV, pages 3 through .

[3]*Id.*, page 12.

erest in real property, whereas the mortgage bond is a type of security in that,

> "A real estate mortgage bond is a participation certificate, usually of $1,000 face amount, in either a large real estate mortgage or in a group of several mortgages which are deposited with a trustee for the bondholders." (Financial Handbook, page 301, *supra*.)

Thus, while the mortgage itself is never thought to be a security, where a mortgage is made the subject matter of a bonding indenture whereby several or many investors can acquire fractional interests in the subject matter of the bonding indenture, then these certificates of fractional interest are securities which meet the traditional test applied in the field of finance and set forth in unequivocable terms in *SEC v. Howey,* 328 U. S. 293; namely, (a) that there be a community of interest in the same subject matter by several investors, and (b) that the investor look solely to others for the development and protection of the profits to be derived.

> "Corporate mortgages taking the form of trust deeds *underlying bond issues* have become primarily income-producing securities, comparable to shares of stock." Powell on Real Property (1952, Published by Bender) Vol. 3, p. 554.

It is generally immaterial whether the indebtedness be embodied in the mortgage instrument itself or set forth on a separate memorandum and incorporated therein by reference for convenience of record keeping or otherwise.[4] As is clearly indicated from an analysis

---

[4] E.g., Cal. Civ. Code, Sec. 2948.

of the legal status of purchase money mortgages and trust deeds in the State of California over the many centuries during which mortgages have been in wide use, they have acquired particular status, operation and characteristics which are totally different and distinct from the basic characteristics of a "security." Moreover, it is clear that securities can be developed from a mortgage by having an indenture and a multiplicity of fractional interests therein issued, but it must be remembered that the security is the certificate of fractional interests in the common subject matter.[5]

Regarding the term "security"[6] as used in the Securities Act of 1933, the construction of which is here at issue, the legislative history of that enactment (H. Rep. No. 85, 73rd Cong., 1st Session at page 11) in explaining the definition as used states as follows:

> "*Paragraph (1) defines the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.* The definition is

---

[5]See Powell on Real Property, *supra*.

[6]Section 2(1), 15 U. S. C. 77b(1) provides in pertinent part: "The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

broad enough to include as securities, for example, certificates of interest in oil, gas, or mining leases or royalties. The definition is again comprehensive enough to bring within its terms certificates of deposit issued by protective committees. It also includes warrants or rights to subscribe to a security, so that the control exerted by this bill commences with the initiation of any scheme to sell securities to the public." (Emphasis added.)

From the foregoing quotation from the legislative history of the enactment here to be construed and the statutory definition itself,[7] it is clear that the term "security" was intended to include that which the term implied in the commercial world, and it recited the basic types and as the foregoing quotation indicates, it went on to specifically specify certain borderline instruments as intended to be included within the statutory definition.

In the light of the issue raised in this case, it is particularly salient that the term "mortgage" or "trust deed" is not to be found in the statutory definition.

---

[7] Section 2(a) of the Securities Act of 1933, or 15 U. S. C. 77b(1) defines a "security" as follows: "The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

"Expressio unius est exclusio alterius" the time honored[8] maxim regularly used in statutory construction[9] here would demand that particularly because of the detailed and lengthy listing of even relatively rare types of transactions to be included within the statutory definition of a "security", the settled principles of construction require a holding that the failure to mention mortgages or trust deeds (which are so important and widely known), clearly indicates that they were not intended to be included within that definition. Scathing the "assumption of arbitrary power by an administrative body" which would otherwise result, see *Jones v. SEC* 298 U. S. 1.

Through the centuries many have tried to make of a mortgage that which it is not. All have failed and the legal maxim "Once a mortgage, always a mortgage" (American Law of Property Vol. IV, p. 107) has sur-

---

[8]"*Expressio unius est exclusio alterius.* The expression of one thing is the exclusion of another. Co. Litt. 210a. The express mention of one thing (person or place) implies the exclusion of another. Broom, Max. 607, 651; 3 Bingh, N. C. 85; 8 Scott N. R. 1013; 12 M. & W. 761; Pearson v. Lord, 6 Mass. 84; Commonwealth v. Berkshire Life Ins. Co., 98 Mass. 29; Trustees of Methodist Episcopal Church v. Jacques, 3 Johns. Ch. (N. Y.) 110; Commonwealth v. Mayor of Lancaster, 5 Watts (Pa.) 156; U. S. v. Barnes, 32 S. Ct. 117, 222 U. S. 513, 56 L. Ed. 291."

[9]See *Taylor v. Michigan P. U. Com.*, 186 N. W. 485, as follows: "The Michigan public utilities commission is a creature of the statute, has no inherent or common law power, all its jurisdiction in any instance must affirmatively appear in the statute before it can be invoked or exercised. *Expressio unius est exclusio alterius* has been a long time legal maxim and a safe guide in the construction of statutes marking powers not in accordance with the common law. 'No maxim of the law is of more general or uniform application, and it is never more applicable than in the construction and interpretation of statutes.' Broom's Legal Maxims, p. 663, cited in Whitehead v. Cape Henry Syndicate, 105 Va. 463, 54 S. E. 306."

l and is clearly evidenced by the special California
ments regarding same, see Cal. Code Civ. Proc.,
Sec 580(b) and 726, *re* single action and no deficien-
cie To attempt to make a "security" out of a regular
gage would be to mock the tradition in which it
eped, the voluminous case law it developed, and the
sta tes which define, control, and/or explain the vast
of law which is labeled "mortgages".

(b) Legislative History Establishes Mortgage and Trust Deeds Not a "Security".

ie fact that mortgages were never intended to be
ded within the statutory definition of the Securities
Ac of 1933 is apparent by examination of its entire
lative history. That Act started as a bill H.R. 5480
e First Session, 73rd Congress pursuant to a letter
the then President of the United States dated
Ma h 29, 1933, to Congress wherein he stated, "I rec-
om end to the Congress legislation for Federal super-
is n of traffic in investment securities in interstate
nerce . . ." and said bill was referred to the *House
Co mittee on Interstate and Foregin Commerce.* All
e foregoing statements are clearly supported by
Ho se Report No. 85, 73rd Cong., 1st Session, pages
1 a d 2.

ouse Report No. 55 of the same session indicates
ha at the very same time, *mortgages* were the sub-
jec of H.R. 5240 which had been referred to the *House
Co mittee on Banking and Currency.* The entire sub-
jec matter of that bill was mortgages and said House
Re rt, page 1, states that,

"The bill as reported by the Committee, except for
a few perfecting amendments is the same as the

> proposed measure as introduced upon the receipt of the *message from the President to Congress, April* 3, 1933, *requesting home mortgage relief.*" (Emphasis added.)

This bill regarding mortgages was so critical, important and significant that it resulted in the "Home Owners Loan Act" which created the Federal Home Loan Bank Board and the Home Owners Loan Corporation (later commonly known as HOLC) as relatively large, independent government agencies (see House Report No. 210, 73rd Congress, 1st Session, particularly page).

As to the relative importance of these two almost simultaneous enactments; namely, the one involving securities and the other involving mortgages, it will be noted that the Securities Act of 1933 created no new agency and carried no money appropriation (about a year later the functions there-under were transferred from the Federal Trade Commission to a new agency, the Securities and Exchange Commission—at or about the time of and by the enactment of the Securities Exchange Act of 1934), whereas the bill dealing with mortgages did create new agencies and carried what were then considered huge money provisions. The reason why this is important is that it not only convincingly esablishes the significance and overall importance of mortgages as such, but makes ludicrous the appellee's position that Congress intended to include the whole genus of mortgages under one of the obscure subspecies of the entirely different genus of securities (and the appellees would have this Court understand that this was done by inference only) since clearly mortgages or trust deeds are not mentioned in the Securities Act of 1933 because of the obvious fact that they are pre-

nted a subject matter entirely foreign to that enact-ent.

This sharp cleavage between mortgages and securi-ts was clearly recognized at the time that the SEC ablished its general rules and regulations under the curities Act of 1933, for even as they stand today ey presume that SEC has no jurisdiction over mort-ges. More particularly, Rule 230 promulgated there-der assumes that a mortgage as such would not be security by virtue of the fact that it *begins* to spell t an exemption, under the security classification for rtain situations wherein there are plural notes issued ainst a single lien real estate. More particularly, ile 230 provides,

> "Promissory note*s* secured by *a* first lien on real estate upon which is located a dwelling or other residential or commercial property shall be exempt from registration under the Act if such are of-fered in accordance with the terms and conditions of this regulation." (Emphasis added.)

ius, the foregoing rule exempting certain certificates ued against an underlying mortgage presupposes at whereas when there is but one indebtedness and e mortgage, there can be no "security" to require an emption, for the obvious reason that it starts to spell t the exempt status amongst plural bonds, etc., issued ainst one underlying mortgage. Logic and grammar rmit no other interpretation.

These regulations which have obviously been, and e required to be, prepared with extreme care, and ive been subjected to continued scrutiny over the 25 ir period since the enactment of the law, cannot be plained away by any clerical inadvertence, and the

very fact that SEC begins to spell out an exemption for certain securities where there is a plurality of divisible interests (up to 125, (Rule 233(a))) in the same singular lien on real estate can mean only one thing; namely, that a mortgage as such is not within the purview of that Act, and that a mortgage can only be brought within the purview of that Act indirectly when securities representing a fractional interest in an indenture secured by a mortgage is involved.

The validity of the foregoing construction is emphasized and reinforced by the rules promulgated by the Securities and Exchange Commission under the later enactment; namely, the Securities Exchange Act of 1934, under which it has long since promulgated Rule 15 a-1, which provides as follows:

> "Rule 15 a-1. Exemption of Individual Notes or Bonds Secured by Lien on Real Estate From Section 15(a). Evidence*s* of indebtedness secured by mortgag*e*, dee*d* of trust, or other lie*n* upon real estate or upon leasehold interests therein where the entire mortgag*e*, dee*d* of trust, or other lie*n* is transferred with the entire evidence of indebtedness are hereby exempted from the operation of section 15(a) of the Securities Exchange Act of 1934, as amended." (Emphasis added.)

Under the foregoing rule, the precise wording can mean only that it is presumed that the status of "security" begins and involves the multiple and divisible evidences of indebtedness in one lien, for that is where the exemption begins and, specifically, the aforesaid exemption covers such plural securities as on one lien *are sold together to one customer,* or, to state it another way, presuming mortgages as such are beyond the pur-

ie of securities, where securities are involved by vir-
ue of multiple fractional interests in the same lien,
the exemption is granted if all of said fractional inter-
st are transferred at one time. The rationale and
upose of this provision is clearly in keeping with the
haracteristics required of a security as set forth in the
Howey case, *supra*.

s to the rules promulgated under *The Securities
A of* 1933 discussed, *supra,* the rule quoted in support
thereof in the main brief was the amended version
thereof published at 18 F.R. 3115, and it is most sig-
nificant that similarly the original version of that rule
published at 6 F.R. 3053 contained the identical pre-
sumption that multiple notes or bonds against a single
mortgage or trust deed were necessary for the status
of "security" to require any exemption or coverage un-
der the Act. Said original regulation reads as follows:

> "Regulation A-R: Special Exemptions
>
> . . . 230.230 $25,000 *exemption of notes and bonds secured by first liens on family dwellings.* Note*s* or bond*s* directly secured by *a* first mortgage or first deed of trust on real estate upon which is located a dwelling designed exclusively for residential use for not more than four families shall be exempt from registration *provided,* That:
>
> (a) The aggregate principal amount of the note*s* or bond*s* secured by *a* mortgage or deed of trust on any single piece of property, and the aggregate amount at which such notes or bonds are offered for sale, shall not exceed $25,000.
>
> (b) *The principal amount of each note or bond shall be not less than $250 and the total number*

> *of notes and bonds on any single property shall not exceed twenty-five.*
>
> (c) The notes or bonds shall be sold for cash or for purchasers' obligations to pay cash within 60 days after sale." (Emphasis added.)

There is no reference in said Act nor any rule or regulation promulgated thereunder dealing with a mortgage other than the foregoing exemption covering certain instances where there are plural securities issued in connection with the mortgage.

Additionally, that the legislative intent was clearly *not* that of making the term "security" cover mortgages is apparent from the very type of *information and data prescribed in detail in that law;* namely, under "Schedule A" thereof (set out in Appendix B of opening white brief) 15 U. S. C. 77aa. Items (1) through (32) thereunder require as the substance of the registration statement particularization of details about factors which home mortgages just don't have, and the whole scope of which is totally inapplicable to mortgages. Since these are statutory requirements, SEC could not substitute inquiries which might be pertinent or have some meaning as far as mortgages are concerned, even if it wanted to do so as a condition precedent to its unauthorized invasion of the mortgage field.

As if the foregoing were not conclusive enough, consistent with every SEC administered Act, the Investment Advisors Act of 1940 fails to include a mortgage or trust deed within the statutory definition of a "security" at 15 U. S. C. 80b (17).

robably even more significant is the definition con-
ni:d in the other SEC administered law; namely, the
Tr st Indentures Act of 1939 wherein, after adopting
th "security" definition contained in the Securities Act
of 933 by reference at 15 U. S. C. 77ccc(1), it goes
on o clearly demonstrate *by statutory definition* pre-
ci y the only manner in which securities arise in con-
ne ion with a mortgage or trust deed; to wit, 15
U S. C. 77ccc(7):

> "(7) The term 'indenture' means any mortgag*e*, dee*d* of trust, trust or other indenture, or similar instrument or agreement (including any supplement or amendment to any of the foregoing), under which securit*ies* are outstanding or are to be issued, whether or not any property, real or personal, is, or is to be, pledged, mortgaged, assigned, or conveyed thereunder." (Emphasis added.)

roving the same thing in a negative way, although
h Act here under construction is over 25 years old,
th SEC has no statutes, legislative history, rules regula-
tio s, authorities or case law tending to show that mort-
ga es or trust deeds come within the purview of the
sta utory definition of "security" necessary to give the
SE any jurisdiction whatsoever in the matter here
be re this Court.

urther evidence of the unquestioned validity of this
co truction and interpretation is indicated in the further
S administered law; namely, the Investment Com-
pa Act of 1940 wherein companies primarily en-
ga d in the mortgage business are, by definition, not
to e classed as an "investment company or brought
w in the purview of that Act" as clearly set forth in
th definitions of said enactment; namely, 15 U. S. C.

Section 80 a-3 (c) which provides in pertinent part as follows:

> "(c) Notwithstanding subsections (a) and (b) of this section, none of the following persons is an investment company within the meaning of this subchapter and sections 72(a) and 107(f) of Title 11: . . . (6) Any person who is not engaged in the business of issuing face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one or more of the following businesses: . . . (C) purchasing or otherwise acquiring mortgages and other liens on and interests in real estate."

In summary, therefore, it is unquestionably established that a mortgage is not a "security" and only becomes involved with securities when the mortgage becomes the collateral behind an indenture under which fractional interests therein are issued, and at that time, it is such a fractional interest therein which becomes a "security" and not the underlying mortgage. This is unquestionably the understanding (1) in the field of finance, (2) in the law which has developed in the use of mortgages, (3) in the law of real property (4) in the legislative history of the Act here to be construed, and (5) under the consistent rules and regulations promulgated by the SEC under the Securities Act of 1933, and the other acts which the SEC administers. Furthermore, it cannot be controverted that what is true of mortgages is true of trust deeds.

(Trust Deeds as Sold by Defendant-Appellants Do Not Become "Investment Contracts".

The leading case of *SEC v. Howey, supra,* clearly indicates that it is merely declaring the widely accepted concept of what constitutes a "security" when it holds that in order to have a "security" there must be two characteristics present; namely, in the language of the Supreme Court.

> "an investment contract for purposes of the Securities Act means a contract, transaction, or scheme whereby a person invests his money *in a common enterprise* and is led to *expect profits solely from the efforts of the promoter* or a third party." (Emphasis added.)

That this concept is generally accepted is further evidenced by the representations of the Securities and Exchange Commission contained in the brief[10] filed January 24, 1958, in the United States Court of Appeals for the District of Columbia Circuit in the matter of *SEC v. Valic* No. 14253 (now 257 F. 2d 201) and signed by the General Counsel, Associate General Counsel, a Special Counsel, and another attorney for the S.E.C. After listing virtually all of the cases in which securities have been disguised as the sales of other things on pages 22 and 23 of that brief, the chief legal officers of the plaintiff appellee herein concluded on page 24 of said brief as follows:

> "A common denominator in all these (Investment contract) cases has been the fact that, in each in-

---

[10] Since this is an opening brief, and the verity of a statement about its own brief is peculiarly within the knowledge of appellee SEC, unless denied in appellee's brief, quotation should be presumed accurate.

> stance, the managers of the enterprise used some of the money supplied to them to perform services which were for the common benefit of all investors, all of whom shared in the profits or losses from these services, and the return was not a sum certain but fluctuated in direct relation to the success or failure of the enterprise. The tangible items sold were part of a contract under which the managers sought to employ the money paid so that each contract holder would share pro rata, in proportion to his payment, in the fruits, if any, of the management services."

The foregoing candid summary of SEC should here be given particular weight, since SEC proceeded such representation to the U. S. Court of Appeals for the District of Columbia Circuit with ". . . As a consistent administrative construction for 16 years, this view is entitled to great weight.", and cited *"U. S. v. Shreveport Grain & Elevator Co.,* 287 U. S. 77 (1932); *Norwegian Nitrogen Products Co. v. U. S.,* 288 U. S. 294 (1933); . . ." and others as authority for such statement.

Thus, it is clear and uncontroverted that in order to have an investment contract, *first,* there must be a common interest in the same subject matter of sale. The Court will note that in the case here at issue a mortgage or trust deed on a particular residential property is sold *in toto* to one customer (as is unquestionably the practice of the defendant-appellants [D "C R. 189] so that no two customers of the defendant-appellants have anything in common in the subject matter of their purchase. By contrast, it is equally clear that if mortgage bonds were involved, then there would

securities, for there the certificate of fractional par-
tipation in the indenture secured by the mortgage
uld be the "security".

Additionally, in the case of the sales made by the
fendant-appellants herein, the *second* characteristic re-
ired of a security; namely, that he rely *solely* on the
forts of the promoter-vendor to provide the profits,
i not present either for the reason that the purchaser
the individual mortgage is given full and complete
ntrol of the mortgage interest which he has bought.
DX "C", R. 189.] Usually, it is recorded in his name
d he must make the determinations as to what is
t be done in the event of any trouble with regard to
orderly payments provided in that trust deed. [DX
", R. 189.] As an accommodation and for business
od will, the defendant-appellants will, if requested,
ceive and transmit the periodic payments made on
trust deeds, but not collect them. In the event of
fault, the customer of the defendant-appellants is the
who would advise the trustee (indicated by the orig-
il issuer of the trust deed and not by the defendant-
pellants) as to what he would want done. [DX "C",
189.]

As clearly set forth in the policy statement of the
npany, [DX "C", R. 189] the accommodations ex-
ded to its customers are of a minor and relatively
onsequential importance. The aforesaid accmmoda-
ns are set out in the Policy Statement of the com-
ny [DX "C"] as follows:

"As an accommodation only, and without obliga-
tion to do so, in order to retain the further good
will of satisfied customers, it is the policy of the

corporation, when specifically requested by the customer to do so, to perform the following:

"1. Without obligation to continue to do so the corporation shall, on a best efforts basis only endeavor to receive and remit payments made by property owners on trust deeds owned by the customers, whether or not said trust deed was acquired through this corporation or otherwise

"2. Without obligation to do so, the company shall endeavor, on a best efforts basis, to find a sale for any trust deed owned by a customer, whether he acquired it through this corporation or otherwise. The price, terms, and conditions in connection with any such sale are to be determined solely by the customer.

"3. The company undertakes to extend to its customers such consultation and suggestions as are customarily extended by banks, saving & loan associations, or real estate brokers, and similar business institutions as relates to the subject matter of the business."

They are not vital to the sale, and if in fact, were found objectionable could be readily curtailed without in any wise interfering with the function of the defendant-appellants. Since they are not vital and crucial to the sale, it is obvious that they could not change the complexion of the sale, and, more particularly, since there could be no question but that the first requisite characteristic is not present and that the second requisite characteristic is not present particularly because the accommodations extended by the defendant-appellants and seized upon by the appellee in desperation are not of

sh a nature as would be a vital part of the sale. F-thermore, the matter of receiving and transmitting ments by a mortgagor or trustor is something that a bank stands ready to do for its customers and d customers of the defendant-appellants could readi- have this function performed by any bank if, in ft, they didn't want to do it themselves. In the event the remote possibility of foreclosure, the customer rely indicates his preference to the previously es- tlished trustee which was neither appointed by, nor is ctrolled by the defendant-appellants herein. That there is no guarantee is made clear from the literature and, m-e particularly, the policy statement [DX "C", R 1] of the defendant-appellants (and even if there were a uarantee running with something other than a se- cuity is not itself a security or, to state it another w, for a guarantee to be a security, it must be a g.rantee of something which is already a security).

As a typical example of a sale by LATD&ME, custom Jn Doe buys a trust deed and gets it recorded in h name. Its characteristics are clearly not those re- qred of a "security" or "investment contract" be- case:

1. No one else has any interest in the subject matter of his mortgage, and that's all he bought.

2. *Sole* reliance for earning of profits is not placed on LATD&ME, but by contract, discretionary acts are reserved to customer, and there are no other significant acts to be performed.

3. No contract exists between LATD&ME other than the purchase order of the customer and the sale of the trust deed thereunder.

4. Affirmatively, customer is required to determine:

A. What trust deed he shall purchase.

B To whom the property owner shall make payments, and what shall be done with the payments.

C. What to do in the event of a delinquency of default.

D. What to do in the event property owner wishes to refinance; *i.e.,* either to subordinate or demand payment in full or in part.

E. What action, if any, is to be taken by a trustee in order to foreclose and on what basis the real property may be sold if title thereto is acquired.

The fact that the defendant-appellants stand ready on a best efforts basis to buy the trust deeds previously sold to a customer is what would be expected of any active merchant who is dealing in particular commodities. The defendant-appellants regularly buy trust deeds from all people who make them available and there is no reason why they should be precluded from considering the offerings of their former customers.

In summary, the trust deed is the subject matter of the sale here involved and there is no accompanying contract. The basic requirements universally accepted for a "security"; namely, (1) community of interest of several investors in the same subject matter, and (2) *sole* reliance upon the promoter-vendors for earning of whatever profits will be divided pro rata are conspicuously absent. By contract, each trust deed was in-

dependently created by a different homeowner, and it covers his particular house, having nothing in common with other trust deeds. There is no additional contract with customers of LATD&ME, and each customer is required to exercise his discretion as to all determinations effecting its status and use. Accordingly, "Once a mortgage, always a mortgage" is here clearly applicable.

C. SEC Stipulated That This Was a National Test Case to Determine Its Jurisdiction, Yet, Induced Trial Court to Deny Discovery of Proof of Lack of Jurisdiction.

Although SEC stipulated that this case was a national test case [see page 10, lines 7 through 12 of Transcript for June 22, 1959], nevertheless, it induced the Court to deny all discovery proceedings by appellants which would clearly establish not only that the matter was beyond their jurisdiction, but the very clear and convincing reasons why it should be kept beyond the jurisdiction [see R. 89, R. 80, R. 126 and R. 110], and the Court did deny such discovery rights [R. 119]. While SEC succeeded in keeping the cloak of mystery and secrecy over the evidence and proof vital to the defense of the appellants' case, at the close of the lengthy trial, apparently as a desperate effort to show the closest thing that it had ever processed in the 25 years of its existence to the registration of a mortgage being sold under circumstances remotely similar to those existing in this case, it introduced the registration of the independent guarantees of mortgages collaterally sold by Mason Mortgage Company [PX 171, PX 171-A and PX .... 172], and this document should clearly demonstrate the reason why SEC didn't want discovery made

and the fact that it had nothing remotely similar to the registration of mortgages or trust deeds sold as such. It will be particularly noted that that which was registered was an independent contract of guarantee of principal and a fixed rate of return which was registered. There simply is no such contract or agreement in the case here under review which could possibly be registered. Particularly, it will be noted that nowhere were the trust deeds of mortgages collaterally sold by Mason Mortgage along with its registered guaranty ever registered nor required to be registered by SEC. What clearer proof is there that SEC does not and cannot require the registration of individual trust deeds and mortgages?

D. This Court Directed Findings of Fact Regarding an "Investment Contract".

In the opinion of this Court in this case in its decision rendered February 17, 1959, at page 20 thereof, this Court had the following to say:

> "We suggest that a proper determination of this case requires a factual finding, in the court below, as to whether there was an investment in a common enterprise,' and whether the purchaser 'is led to expect profits solely from the efforts of the promoter or a third party.' *SEC v. W. J. Howey Co.*, 1946, 328 U. S. 293, 298-99."

Notwithstanding the direction of this Court in the findings of fact and conclusions of law, after a prolonged diatribe of argument, misstatements and speculation, at page 46 thereof, the trial court states:

> "The elements that make up an 'investment contract within the statutory definition, as distinguished

from some other form of security, are not amenable to characterization in absolute terms. Consideration must be given to all surrounding and collateral arrangements. Measured by the standards enunciated in *S.E.C. v. Joiner* and *S.E.C. v. Howey Co.*, the Court finds *categorically* that the instruments offered by the defendants are 'investment contracts.' "

Thus, it jumped at the conclusion that a mortgage had been mystically turned into an investment contract without providing any formula or detailed analysis which would permit a reasonable person to determine the point at which a mortgage was so transformed. It completely failed to particularize the specified ingredients set out in the definition of an investment contract which has been time honored and memorialized in the *Howey* case.

E. Customer Witnesses Called by SEC Failed to Establish Necessary Ingredients of an Investment Contract.

Customer James West, Jr., called by SEC [T 227] established that he relied in no manner upon the appellants for selection of the trust deed which he bought, and using his own judgment, ultimately rejected three trust deeds offered to him by the appellants. [T 263.]

The only other customer witness was a Mrs. Korenbe called by SEC [T 148] from beyond the jurisdiction of the Southern District as a surprise witness and had her give direct testimony leaving the impression at the close thereof that she had given $35,000 to LATDOME and couldn't get it back. By good fortune and almost fantastic speed, appellants were able to establish before she left the witness stand and, hence, the juris-

diction within which she could be recalled as a witness, the fact that she gave them nothing but a rubber check. [T 168] [DX-A at T 172.] Further, it was established that various of the SEC counsel and staff had coached Mrs. Korenberg with regard to her testimony. [T 190.]

Since the SEC, an instrumentality of the federal government, had abnormal investigative powers and staffs to seek out hundreds of customers of the appellant, it is clear that when they produced only Mr. West and Mrs. Korenberg that these were the best witnesses SEC could find. The hypocrisy implicit in the instructing and coaching of Mrs. Korenberg and the absolutely false impression she left on direct examination is shocking and constitutes action on the part of over zealous bureaucrats which should not go unpunished, for it strikes at the very vitals of our system of justice and is particularly bad because of the presumption of integrity which must necessarily be accorded proceedings on behalf of our government. It is but another instance of the hypocrisy practiced by SEC throughout this trial, another horrible example of which is the contrived balance sheet used to allege insolvency as of March 31, 1959.

F. The Economic Aspects of This Precedent on the Mortgage Industry Are Extremely Far-Reaching

The vast implications of the jurisdictional issue in this case can not be properly evalued without reflecting upon the size of the industry which would be effected by a ruling that the SEC has jurisdiction in the mortgage industry. The following facts are taken from the Statistical Abstract of the United States, 1959, published by the Bureau of the Census, U. S. Department of Commerce.

F st, on page 307, it is disclosed that for the year 95 as to the National Income By Industrial Origin, he tal of all industries was approximately $364 bil- n and, of that figure, approximately $22¼ billion vas attributable to the real estate field. Moreover, n ge 309, it is indicated that for the year 1957, n alyzing the Components of Personal Savings, that ll rsonal savings totaled $20.7 billion, and of this ti al inclusive figure, $15.2 billion less $4.6 billion p ciation thereon, or a net of $10.6 billion, was in- st l in non-farm homes as the net equity. Thus, r at rather typical year, half of all of the personal avi gs of this nation were represented by equities in n arm homes. Again, on page 324, for the year 95 in analyzing National Wealth By Type of Asset n rrent Dollars, of the total national wealth of ap- ro mately $1,448 billion, $350 billion was represented y n-farm residential structures, plus a large invest- ner in the land incident thereto not specifically segre- ate under a caption in the tabulation representing 10 billion of which a part thereof would be for said nd

alyzing the position of the mortgage industry in ela n to the general real estate industry on page 767 or e year 1950, it is indicated that there were approxi- nat y 43 million occupied dwelling units of which 55% ver owner-occupied; and, further, that of the owner- cc ied dwelling units, 43% of them were mortgaged. g n on page 751 for the year 1956, the number of wn -occupied non-farm dwelling units had increased o .501,000 units of which 12,713,000 were mort- ag ; and, further, that whereas the total value of the wn -occupied mortgaged, non-farm properties was

$170 billion. The mortgages against same amounted to approximately $85 billion.

Again, on page 772, for the year 1956, of 25.5 million owner-occupied dwelling units, 59.4% were mortgaged. Further analysis on page 772 reflects that for 1956 for the total number of mortgaged non-farm dwelling units, 19% were mortgaged under FHA, 5% under Veterans Administration, and 56% under conventional.

On page 773, the mortgage debt for 1958 totaled $171 billion, of which life insurance companies held at the end of the year $37 billion and savings and loan associations $45 billion.

Moreover, on page 774, for the year 1958, there were 3,441,000 newly recorded non-farm mortgages of 20,-000 or less, and of these, 692,000 were held by individual and 577,000 by miscellaneous mortgages other than the characteristic financial institutions; and, further, that as to the newly recorded mortgages reflecting individuals as the mortgagee, the amount involved was $3,435,000,-000, in addition to which the amount recorded in the name of miscellaneous mortgages (other than financial institutions, etc.) was in the amount of $5,133,000,000.

(Interestingly enough, Table 1045 on page 774 reflects that the total newly recorded non-farm mortgages for the five year period ended in 1958 totaled 17,-659,000 mortgages and Table 1050 on page 775 indicates that for the same five year period nationally there were 166,274 foreclosures, or less than 1%.)

Additionally, there was read into the record pertinent excerpts from DX-S a Congressional Committee report of January 26, 1960, wherein housing officials are

q ted as indicating that *second* trust deeds or similar i ancing devices are used in a remarkably high perc tage of all home sales in the following pertinent l guage quoting an official of the Federal Housing Aministration at page 5 as follows:

"*Insuring office*: *Los Angeles, Calif. September* 23, 1959.

1. In your opinion how extensively are second mortgages, land-sale contracts, contracts for deed, or other devices designed to lower the initial equity required from the home borrower being used in the conventional mortgage sector in the current market?

On single-family residences, in approximately 75 to 85 percent on new construction; on existing construction, 50 to 65 percent.

Attention is called to the fact that this latter figure may not give a true picture, as we find that a very high percentage of lower priced existing homes (90 to 95 percent) and a very small percentage (10 to 15 percent) of higher priced homes are financed with second mortgages."

The economic phenomenon of the tremendous growth i importance of *second* mortgages in home sales seem t follow the following economic developments. Prior t 25 years ago, a substantial down payment was typi ly exacted from a purchaser of a home. As a r ult, frequently the head of a household had to save o r a period of many years before he was able to a uire his own home, frequently his first home, by w ich time his family was half grown. Through vari s national programs, notably FHA and VA loans,

there was developed a method whereby a head of a family could acquire a home with relatively little down payment and as a result, the percentage of families which did own their own homes increased very appreciably. However, with the advent in the past several years of hard money conditions, the use of these FHA and VA loaning programs became less and less acceptable to the traditional financial institutions in the home mortgage field. As a consequence, conventional loans made by savings and loan associations, insurance companies, banks and other regular financial institutions without any guarantee or insurance by any federal agency, were relied upon most heavily with the consequence that since such loans were made for a maximum of approximately two thirds of the purchase price, additional financing was usually required. Thus, since a change in the American way of life with regard to home acquisition and a drying up of potential home buyers with substantial down payments to make had occurred, it was necessary to supplement the financing available on the conventional first mortgages granted with supplemental second mortgages on the same properties. Hence it has developed that said second mortgages are used in a vast majority of all present home sales and if they are not used, one of two results will occur; namely, (1) the home building industry, the largest single industry in our economy, will be curbed because of a dearth of eligible buyers, or (2) government guarantees at substantially advanced interest rates attractive to the lending institutions will be required.

G. SEC Registration and Procedures Having Been Intended for an Entirely Different Field Are Totally Inapplicable to the Sale of Individual Trust Deeds by Appellant and There Is No Manner in Which They Could Be Complied With.

xamination of the data required by statute for reg-
tration (See 15 U. S. C. 77aa—Schedule of Infor-
ation Required in Registration Statement) proves it
sumes that there is a multiplicity of identical fungible
s. There are no such identical fungible units in-
ed in the activity of the appellants.

H. SEC Has No Jurisdiction to Seek or Obtain a Receiver.

*In carrying out its statutory mandate the Com-
sion is given certain clearly specified enforcement
ers which are limited to preventing the offering or
a of securities in violation of the Act's anti-fraud
full disclosure provisions.* Section 20 of the 1933
. which defines the Commission's role in the Act's
all enforcement scheme (15 U. S. C. par. 77t),
orizes the Commission to conduct investigations
never it appears that the provisions of the Act or any
or regulation prescribed thereunder, "have been or
about to be violated" (sec. 20(a)) and it further
orizes the Commission to bring suit for injunction
never it appears "that any person is engaged or
t to engage" in any acts or practices which con-
ute such a violation (sec. 20(b)). Finally, it au-
izes the District Courts to issue writs of mandamus
ompel compliance with the Act upon application of
th Commission (sec. 20(c)). In construing this lan-
ge of sec. 20(b), the courts have generally held that
ence of past violations, which authorizes SEC to

conduct an investigation, will also justify the inference that the violation will continue unless enjoined. But the relief awarded in such cases has been directed solely to prevention of future violations, *SEC v. Torr*, 87 F. 2d 446 (2d Cir., 1937); *Otis & Co. v. SEC*, 106 F. 2d 579 (6th Cir., 1939). We have found no reported case to date where a court has ordered rescission or restitution for an unlawful transaction in a suit brought by the SEC.

2. *The remedy for past offenses is vested by the Act in the injured purchaser himself and in the Department of Justice, but not in the Commission.* The Act provides a two-fold remedy for past violations: Section 24 (15 U. S. C. sec. 7w) makes it a criminal offense to wilfully violate any provisions of the Securities Act and imposes a criminal penalty in the form of a fine or imprisonment for those convicted. Moreover, section 12 of the Act (15 U. S. C. sec. 77 l) gives every purchaser of a security sold in violation of the Act or by means of misrepresentation, the right to recover a judgment for either rescission or damages in the Federal court, regardless of the amount in controversy, and facilitates such a recovery by reducing the purchaser's common law burden of proof. Nowhere in the Securities Act, however, did Congress provide for an action by the Commission to compel restitution to such injured purchasers. *Cf. SEC v. Fed. Compress and Warehouse Company* (D.C.W.D., Tenn., 1936) CCH Securities Reporter sec. 2911.22, sec. 90106, 1941-1944 Dec.

3. *The SEC has asked Congress to broaden its statutory enforcement powers so as to enable it to remedy past non-compliance as well as to compel future compliance but Congress has not seen fit to adopt the Com-*

is on's proposed amendment. Recently, the Commis- has been engaged in efforts to strengthen its en- ment powers by amending the Securities Act of 19 so as to fill in the gaps in its jurisdiction under the present law. In 1957, it submitted a proposed bill e 85th Congress which, according to the Commis- Chariman at that time, was "designed to strength- jurisdictional provisions, correct certain inadequa- ies facilitate criminal prosecution and generally strgthen the Commission's enforcement capabilities". J. Sinclair Armstrong, Current Developments in Regu- ati of the Securities Market, Congressional Record 5t Congress, 1st Session, Vol. 103, Part 2, page 2404.

The proposed bill which the Commission submitted to ongress[11] and which was introduced on July 15, 195, would have changed section 20(b) to read as fol- lows:

> "Whenever it shall appear to the Commission that any person *has engaged,* is engaged or is about to engage in any acts or practices constitut- ing a violation . . . *or that any person has failed o comply with the provisions of this title,* any rule or regulation prescribed under authority there-

---

[11] the explanatory statement which acompanied the bill, the Commission described the amendment's purpose as follows: "Th statute contains provisions for enforcement by the Com- mission through administrative and injunctive actions and for e ferral of information concerning violations to the Depart- ment of Justice for criminal prosecution . . . A substantial number of the proposed amendments are designed to make the Commission's enforcement actions more effective in eliminating or minimizing various technical problems which have come to light in the course of Commission's enforcement of the statute over the past two decades." Proposal of the SEC to amend the Securities Act of 1933, as amended. Congresional Record, 85th Congress, 1st Session, Vol. 103, Part 9, page 11632.

> of, or any order of the Commission in pursuance thereof, it may in its discretion, bring an action in any District Court of the United States . . to enjoin such acts or practices *and to enforce complaince with this title or any such rule or regulation or order. Upon a proper showing that such person has engaged, is engaged or is about to engage in any such act or practice or that he has failed to comply with this title or any such rule, regulation or order,* a permanent or temporary injunction, restraining order, *or other order* shall be granted without bond." (Emphasis added to denote proposed new language.)[12]

The Commission's proposed amendment was referred to the Senate Committee on Banking and Currency, but was never enacted.

An examination of the new language which the bill sought to add, set forth in the italics, brings into sharper focus the inadequacy of the present law to authorize the appointment of a receiver. If it had been passed, the Commission's amendment would have authorized it to go into court on a showing of past violation or non-compliance whether or not the violation was a continuing one, and whether or not there was any likelihood of its future recurrence. Moreover, it would have conferred upon the Commission comprehensive power to enforce compliance not only by means of prospective injunctive relief, but by "other order" as well.

Had it been enacted, the proposed amendment might have provided some statutory foundation for the ap-

---

[12]Senate Bill S. 2544, Congressional Record, 85th Congress, 1st Session, Vol. 103, Part 9, page 11631, *et seq.*

appointment of a receiver in this case.[13] However, a request by the Securities and Exchange Commission for additional enforcement powers is not the equivalent of an Act of Congress. It may well be that as a matter of public policy it would be wise to give the Commission the additional remedies it requests and to fill in the gaps in its present enforcement powers. We submit, however, that as Congress has not done so, the courts have no power to do so.

The SEC had no standing to sue for a receiver

It is well settled that before a federal court will entertain a prayer for receivership, it must satisfy itself that the complainant has standing to seek such extraordinary and drastic relief. *Home Mortgage Co. v. Ramsey*, 49 F. 2d 738 (4th Cir., 1931), *Maxwell v. McDaniels*, 184 Fed. 311 (4th Cir.). Before a litigant can invoke the jurisdiction of a court of equity and pray for the appointment of a receiver, he must show that he has a substantial interest in the property.

The fact that the defendant corporation has been guilty of fraud will not of itself enable the plaintiff to have a receiver appointed over its property. Clark on Receivers, 3rd Ed. (1959), secs. 180-182. Hence, it has been held by the Supreme Court that an unsecured contract creditor, in the absence of statute, has no substantive right, legal or equitable, which would justify

---

[13] Cf., *Porter v. Warner Holding Co.*, 328 U. S. 395, 397, where §205(a) of the Emergency Price Control Act, 50 U. S. C. A., Sec. 92(a) (1946) was construed as authorizing the OPA to seek restitution on behalf of injured purchasers. The decision turned on the language of that statute providing for the issuance of an injunction *"or other order"* by the court upon application by the administrator for such injunction or *"an order enforcing compliance."* See also *United States v. Moore*, 340 U. S. 616 (1951).

the appointment of a receiver at his behest, and this is true regardless of the misfeasance of the defendant. *Pusey and Jones Co. v. Hanssen,* 261 U. S. 49, 43 S. Ct. 454. And it is generally held that a corporate officer, who is neither a stockholder or creditor has no standing to obtain the appointment of a receiver. Fletcher, Treatise on Corporations (1942 Ed.), Vol. 16, sec, 7687. The courts have uniformly held that the plaintiff must have some interest, such as a lien or charge on the property or some tangible and substantial claim against it which will justify a court in taking control.

Jurisdiction to apply for a receiver may be conferred upon a public official by statute; but in the absence of statutory authority, a public agency, such as the SEC, has no standing to seek receivership relief. Fletcher on Corporations, *supra,* sec. 9695; *State v. New Orleans Debenture Company,* 107 La. 562, 32 So. 102; *Sternberg v. Vineland Trust Company,* 107 N. J. Eq. 255, 152 Atl. 370; American Jurisprudence, Receivers, sec. 17.

In *Deckert v. Independence Shares Corp.,* 311 U. S. 282, 61 S. Ct. 229, the Supreme Court approved the appointment of a receiver in an action brought under the Securities Act of 1933. But in that case the appointment was made upon application of an injured purchaser suing to enforce his right to a pecuniary recovery under section 12 of the Act. The Court held that:

> "The Securities Act does not restrict *purchasers* seeking relief under its provisions to a money judgment. On the contrary, the Act as a whole indicates an intention to establish a statutory right which the litigant may enforce in designated courts

by such legal or equitable actions or procedures as would *normally be available to him.*" (311 U. S. 282, 287; emphasis added.)

A court of equity has always had jurisdiction to grant a receivership upon the application of a prospective judgment creditor. The court did not, however, consider the question of the SEC's right to obtain a money judgment under the Securities Act, let alone a receivership in aid thereof.

There are a number of reported cases in which the SEC has obtained a receivership. In most of these cases, it will be found that the appointment was not contested, and in others, it was made under one of the other statutes which the Commission administers. Under the Investment Act of 1940, for instance (15 U. S. C. A. secs. 80a-26 and 80a-35), the Commission is authorized to obtain relief against the offending officers themselves or to wind up a delinquent company.[14] In such actions, a receivership is proper as an ancillary remedy to the ultimate relief which the statute authorizes.

To justify the appointment of a receiver, it is necessary that some proper final relief be asked for which will justify the Court in proceeding with the case. Pomeroy Equity Jurisprudence, 4th Ed., sec. 1539. "The

---

[14] See *SEC v. Aldred Investment Trust*, 151 F. 2d 254 (1st Cir. 1945), and *Bailey v. Proctor*, 160 F. 2d 78 (1st Cir., 1947), where a receiver was obtained in aid of the Commission's power to proceed against officers and directors of an investment company for gross misconduct or abuse of trust. 15 U. S. C., Sec. 80a-35. See also Sec. 26 of the same Act which provides for an action by the Commission to seek liquidation of an inactive investment trust. *SEC v. Fiscal Fund*, 48 Fed. Supp. 712 (D. Del. 1943).

proposition is well settled that a Federal Court has no jurisdiction to entertain a suit for the appointment of a receiver where the receivership is sought as an end in itself and not as ancillary to other relief." *Home Mortgage Co. v. Ramsey,* 49 F. 2d 738, 743 (4th Cir., 1931). And in *Gordon v. Washington,* 295 U. S. 30, 55 S. Ct. 584 (1935), the Supreme Court reversed the appointment of a receiver for the same reason:

> "There is no occasion for a court of equity to appoint a receiver of property, of which it is asked to make no further disposition. . . . A federal court of equity will not appoint a receiver where the appointment is not ancillary to some form of final relief which is appropriate for equity to give." 295 U. S. 30, 37-38.

The Commission cannot seek the appointment of a receiver in aid of a prospective money judgment because the Commission is not authorized either by the Securities Act of 1933 or the Securities Exchange Act of 1934, to apply for a judgment of restitution or for any other pecuniary recovery. Nor is the Commission authorized to apply to the courts for an order decreeing the liquidation and dissolution of a corporation that has violated the Act. Whether or not such relief might be available at the suit of a security purchaser under the civil liability provisions of the Act, it is clear that the SEC has no standing to sue for such a decree. The order appointing a receiver in this case was, therefore, beyond the jurisdiction of the court, and a void order.

I. Appellant Corporations Were Solvent.

he solvency of the appellant corporations is clear- stablished by the unchallenged certified report by ndependent CPA [PX 42] introduced by the SEC t time when they had said CPA on the stand and ll his work papers and schedules with him and which SEC had marked for identification and subsequently fully examined. [PX 83, PX 84, and PX 85.] It be noted that there was no attempt to discredit nor rove this statement establishing solvency as of Sep- ber 25, 1959, a date only a few weeks prior to the mencement of the trial in this action and many ths subsequent to the date (March 31, 1959) of the rived balance sheet on which SEC predicates its ations of insolvency. Additionally, the impropriety he contrived adjustments by SEC was established n independent practicing CPA, Mr. Edwin Russ [T 3230, *et seq.*], who also confirmed the fact that flected solvency on the part of the corporate appel- ar .

is Court might well judicially note the financial ment of Arthur Young and Company submitted he receiver in this action and annexed to the re- r's motion on the matter decided by this Court in pinion dated July 14, 1960, wherein this CPA firm, h the Court might judicially note is one of the st in the nation, found the assets as of the date the receiver took over (June 17, 1960) to greatly d the liabilities of the corporations in receivership.

J. Broker-Dealer Formula Regarding Net Capital Rule Totally Inapplicable and Misapplied.

In the opinion of this Court rendered in this case February 17, 1959, this Court properly criticized the SEC's arbitrary and highhanded misapplication of its net capital rule as far as these appellants are concerned. SEC's own witness admitted (See brief on behalf of other appellants in this regard) that the rule was never designed for an organization dealing in mortgages or trust deeds and application would necessarily be arbitrary for these reasons. The fantastic degree of the arbitrary applications identical to those which this Court previously criticized can be seen in the transcript [T 2843, *et seq.*, and T 2956, *et seq.*, and T 3472.]

Clearly it has no pertinency nor application to the business of the appellants and must be disregarded for the reason that it was prepared in the same arbitrary manner criticized by this Court in its opinion of February 17, 1959, (see page 12 of said opinion).

K. Cumulative Effect of Numerous Errors in Admitting Evidence Offered by SEC Require Reversal on That Ground.

In addition to the errors regarding the admission of evidence offered by SEC set out in the brief on behalf of the other appellants which cumulatively are so gross as to be totally prejudicial to a proper consideration and conclusion in the case, the attention of the Court is directed again to the fact that despite standing objections recognized by the Court [T 5 and T 158] to admission of evidence regarding transactions after the filing of the amended complaint and no attempt whatsoever to further amend the complaint on

...h trial was had, the findings of fact and conclu-
...of law are made up principally of facts and is-
...totally foreign to the pleadings. In an action
...as this seeking penalties and forfeitures, it is to-
...unconscionable, as well as contrary to pertinent
... to hail defendants into Court on certain issues
...hen proceed to try them on a hoard of different
...dditional issues without any notice or the pro-
...ns implicit in knowing what the framed issues
... On this ground alone, the decision should be re-
...d.

...he District Court Erred in Not Granting Motion ...r Mistrial After Days of Trial With Certain De-...ndants and Their Counsel Gagged.

...spite timely motion made [T 392] for mistrial ...e ground that several days of trial were had when ...n defendants and their counsel were precluded from ...ding or objecting as to certain testimony and evi-... under the saction imposed under Rule 37(b) which ...ater rescinded in a tone clearly indicating a prej-...l attitude on the part of the trial judge [for ...r examples of the hostility toward the appellants ...heir counsel, see T 501, T 509, and T 511].

...enial of All Discovery Rights to the Appellants ...d Granting Carte Blanche Discovery Rights to the ...ppellee Constituted Prejudicial Error.

...spite a complete, well documented, particularized ...ise to an order to show cause establishing why ...efendants needed the discovery [R 89] all dis-... rights were denied to the defendants and this ...anded and arbitrary action precluded a proper ...ration of the defense of this case totally contrary ...d in flagrant violation to the Federal Rules of ... Procedure.

N. The Case Was Prejudged as Established by Certain of the Trial Judge's Comments.

Despite the direction of this Court that the matter be tried to make certain factual findings regarding the possibility of the existence of an investment contract, the trial judge [T 390] openly declared that he was proceeding as though SEC had jurisdiction, and despite the fact that appellants' counsel took appropriate objection [T 408 and T 425] to this assumption, the trial continued on that pattern.

Wherefore it is respectfully prayed that the decision of the lower Court be reversed and this Court find that the SEC is without jurisdiction over the appellants and the receivership be terminated.

Respectfully submitted,

Paul J. Foley,

Attorney for Appellants.